RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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September 19, 1984 **LETTER 896**

Sept. 7 DJIA 1207.38; PTI 1589; A-D Ratio -20.61
Sept 14 DJIA 1237.52; PTI 1611; A-D Ratio -19.85

THE PICTURE: Well, it finally happened. The PTI on September 13 surged above its 21-week moving average, thereby rendering a bull signal. In so doing, the PTI turned the 21-week moving average to the upside, and that's the signal we were waiting for. I can't tell you how long the 21-week MA will continue to climb, I can't tell you how far it will climb, but I can tell you that it pays to invest in harmony with the 21-week moving average of the PTI.

To go back a bit, the PTI hit bottom on July 24 at 1519, and then turned up. The PTI broke above its long declining trendline on August 9, and this was discussed at the time. At no time since July 24 has the PTI looked anything but bullish. Nevertheless, I placed only "half a bull" in the Investment Position box, because I wanted that major signal from the PTI, regardless of how good the situation looked. On September 13 the major bull signal came. If you've been fighting this market on the short side, get out now (just in case you haven't already been blown out!). If you are under-invested, this is the time to take a chance and "up" your position. If you trade no-load funds and you've made a preliminary switch as suggested here a few Letters ago, you can move into a fuller equity position now.

If you're in bonds, you needn't wring your hands either. Those subscribers who bought bonds as suggested a few months ago have pretty fat profits now. The bond market is strong, very strong, and this is discussed in a later section of this Letter.

This market has been quite selective and "blue chippy" up to now, but remember the Value Line point &figure chart in the last Letter? That chart suggested broad upside participation if the Value Line Composite broke out topside at a price of 184 or more. On September 13 the Value Line closed just a fraction under 184. With the PTI in a bull trend, the Value Line is almost sure to go through.

I'm not going to reprint the P & F chart of the PTI (see last Letter), but the base is now complete, and the PTI is moving out. So as this Letter is written we have the PTI rising out of its base, the Value line moving out of its base, and bonds pushing up from their own base.

I'll confess something. I'm more careful now than I've ever been about writing a long-term scenario for this market. I know about the compounding power of debt, I know that President Reagan is 73, I know the Russians are building a military colossus, I know that the leading economic indicators are sliding. But the PTI is bullish, and that will suffice for the present.

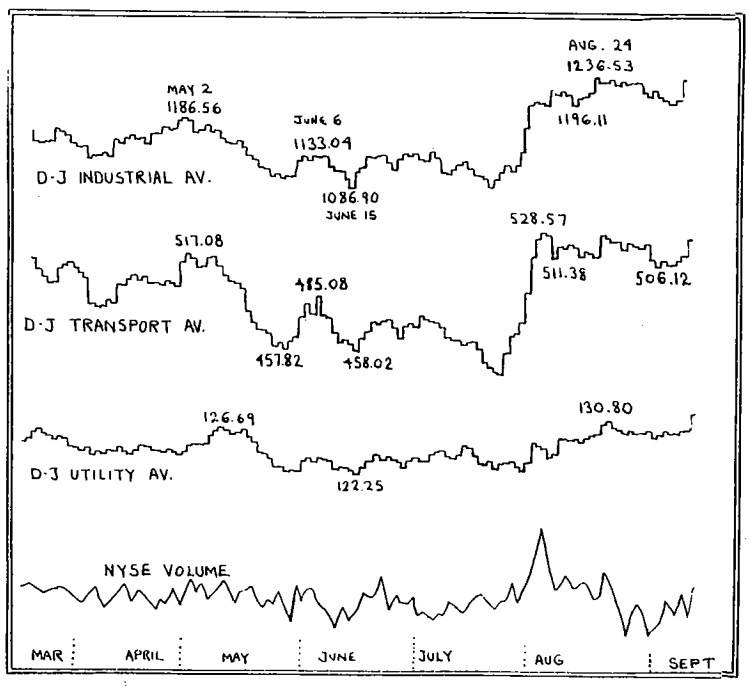
One of the things I like about my PTI is that it doesn't operate on the basis of scenarios, it doesn't care about ascending triangles or the debt picture or Illiott Waves or interest rates. The PTI simply measures market ACTION—no more and no less. I feel safe when I'm in the market and the trend of the PTI is up. I feel scared to death when I'm holding stocks and the trend of the PTI is down.

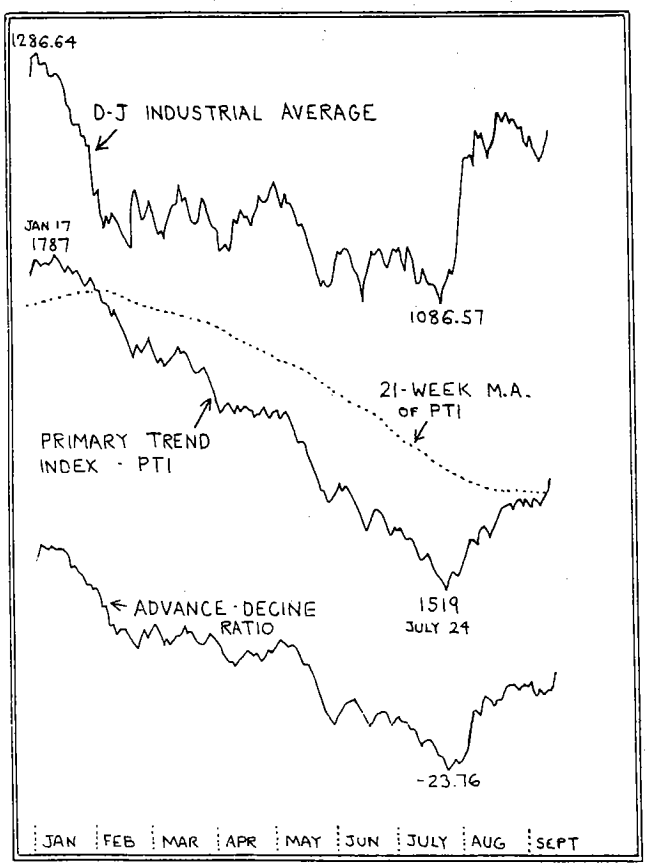
All right, what about the Averages (this is , after all, Dow Theory Letters)? In the last Letter I explained how over the near-term the key was the ability of the Dow to hold above 1196.11 and the Transports to hold above 511.38. Following that Letter the Transports broke down to 506.12—but the Dow held. Thus, we witnessed a perfect downside non-confirmation. Under Dow's Theory, a penetration of one Average unconfirmed by the other is MEANINGLESS for prediction purposes and more apt than not to be deceptive. The result of the non-confirmation was a reversal to the upside—all simple enough for followers of the Dow Theory.

Here are a few more technical points: (1) TheA-D line on the NYSE (a proxy for all NYSE stocks) has held very well. You can see this important indicator on the page 2 chart. The A-D ratio never really gave up much on the downside, and when the big September 13 day hit, the A-D bounced to a new high.

(2) September 13 saw upside volume surpass downside volume on a 9 to 1 ratio. This is BIG power, and it is the third such day since August 1. That's impressive. On the face of it, four 9 to 1 upside volume days since August 1 suggests a big market ahead.

(3) I keep an A-D line of the (daily) 15 most-active stocks on the NYSE. The trend of the most actives pretty much reflects the





path of big investment money. This index rose to a 1984 high on September 13.

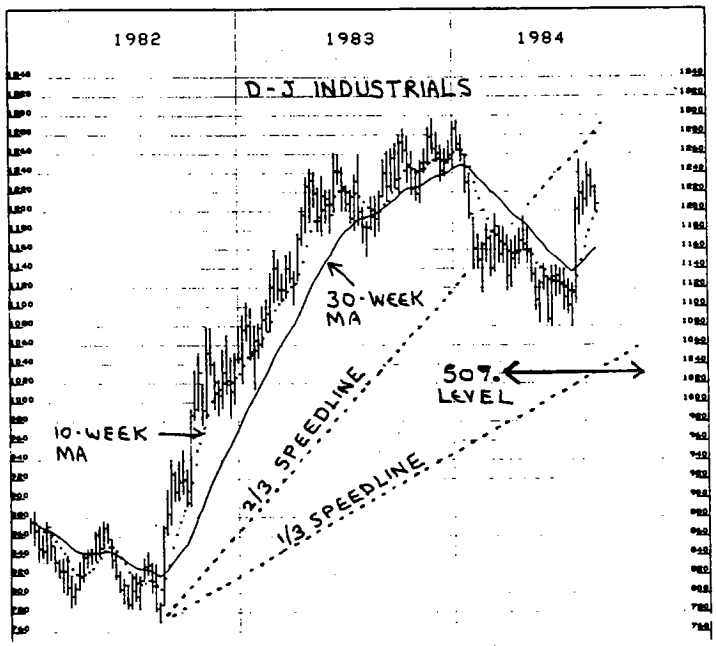
(4) Here's an item few people watch. The NYSE Financial Index contains all the finance-related stocks on the NYSE: the Banks, the Savings & Loans, the Small Loans, etc. On September 12, this index (after acting better than the market for weeks) rallied to its highest level since late-March. Bank stocks firmed dramatically. And I take this to be very bullish for the whole US financial picture (including the foreign loan situation). JP Morgan moved up over 70 (I consider JPM a bellwether).

(5) On September 12 the D-J Utility Average closed at 131, highest level in seven months. The Utility Average tends to be a market bellwether. New recovery highs in this Average has to be taken positively by the market.

(6) My on-balance-volume index for the NYSE hit a new 1984 high on September 13. My positive volume index for the NYSE (based on volume on days when volume expands over the previous day's volume) also hit a new high on September 13. These studies are characteristic of the kind of volume indications one sees in a bull market.

DOW: The Dow isn't the market, as almost every analyst is fond of pointing out. But the general market never goes very far without the Dow, and the Dow never goes very far without the general market following.

Therefore, what the Dow does, and what it doesn't do, is always worth studying. This weekly chart (opposite, above) shows us a lot, and it provides a number of guidelines with which we can gauge future Dow action. On the chart we see a 30-week moving average and a shorter 10-week MA (dotted line). Note that the two MA's are in the bullish mode now, with the 10-week MA above the 30-week MA, and the Dow above both MA's. The



30-week MA is at roughly 1165 at present. When the 10-week MA moved above the 30-week MA, we received a bull signal on this method.

Then we have two speedlines, and what the Dow does in relation to the speedlines is important. When the Dow cracked below the 2/3 speedline the implication was that the Dow could come down to test the 1/3 speedline. So far, the nearest the Dow has come is the July low, but at that point the Dow was still 60 points above the 1/3 speedline. That kind of action impresses me.

Finally, we have the 50% level or the halfway level of the entire 1982-83 advance. This level is 1032. It is a bullish point that nine months have now elapsed since the Dow top in January, and the Dow has never come closer than 54 points from the 50% level. The longer the Dow fluctuates ABOVE the 1032 halfway level, the more positive the picture.

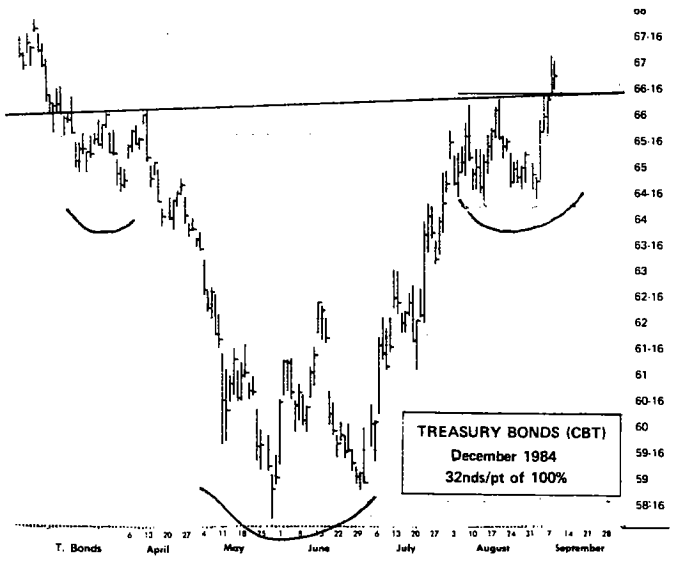
CONCLUSION: I have pictured three important gauges of Dow strength or weakness. On each of the three, the Dow receives a bullish grade. I have discussed the 50% Principle many times during 1984. This, in particular, has been a major factor in my not becoming too bearish even during the first seven months of 1984.

INVESTMENT POSITION: I've taken the half-bull out of the box, and the whole animal is in there now. Yes, I know all the arguments about the dangers and slow-ticking time bombs in today's economy. And I know that Henry Kaufman is predicting higher interest rates. But if you believe that the market is its own best leading indicator then you have to believe what this market is saying. And as I've suggested ever since July, the market has been (and still is) telling us a bullish story. And that's exactly the story that I'm repeating to you. So why fight it?

The strongest Dow stocks are Westinghouse, Owens-Illinois, United Technologies, IBM, American Express, and Int. Paper. FMC looks like a winner, and I like JP Morgan. BDM Int.(Amex) looks to me like a star of the future. So does Logicon (Amex).

BONDS, INTEREST RATES: I don't promise to explain why markets do what they do, but I know an interesting chart when I see one. This chart (page 3) is interesting.

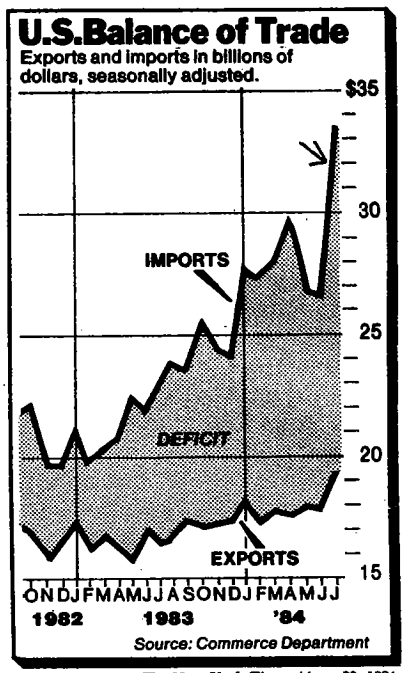
Here we see a daily chart of the December Treasury Bond futures, and it's a chart I've liked ever since July. But now the chart is talking, and it is saying that a big base has formed. The breakout came last week as the December contract hit 68, a fat 10 points above the May 31 low.



As I said, I can't offer the real inside explanation for every move, but I can tell you that this is a strong chart. When bonds go up, interest rates come down, and strange as it may seem, that is what we're headed for now. If that happens, those of us who own bonds are going to be very happy, and Walter Mondale is going to have an even harder time explaining the Reagan economy. At any rate, this chart says the long side of the bond market is the right side to be on! Argue with it at your own peril.

IMBALANCE: The US balance-of-trade is so bad that even the newspaper pundits are issuing warnings or offering cures. But there's no easy cure for what's happening. This chart tells the story, and as you can see the July imports exploded to almost $34 billion, thereby stretching the trade gap for that month to a record $14.1 billion.

In my opinion, two major events are taking place. First, the dollar is strong, extraordinarily strong. I've included this chart of the Swiss franc to show readers what has happened to a currency which, for years, has been a tower of strength. The Swiss franc has during 1983 and '84 collapsed against the dollar. In fact, except for the Japanese yen almost every major currency (and all the minor ones) have caved in against the dollar. The British pound (which sold for over $4 when I was a boy) is down to $1.30, and there is talk of a one dollar pound! That's how extreme it is.



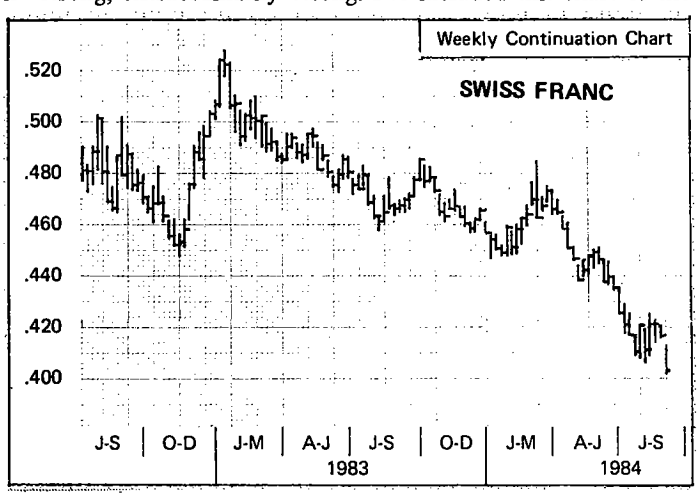
All this means that it's very expensive for foreigners to buy US goods with their weak currencies, and it's a bonanza for Americans when it comes to buying foreign goods. And as you can see by the chart, Americans are buying foreign goods like there's no tomorrow.

That's one factor. The other is that foreigners (particularly Japan and the Asian nations) are turning out excellent products, competitive products, and high quality products. But something new has been added. Whereas the US once held undisputable technological lead as far as new products are concerned, that picture is changing. The fact is that Japan has now taken over certain industries, and she is moving into new ones. Japan long ago mastered the art of production, and she is now (with vast government help) moving towards technological parity and even leadership in many industries.

Thus Americans have a double incentive to buy foreign goods–the dollar buys a lot, and foreigners offer a lot in terms of quality, technology and design.

Where will it all end? How will it all end? Nobody knows for sure. My own feeling is that it is nice to have a strong currency. It's nice that everyone wants dollars. But the super-strong dollar is working hardships on American manufacturers, and the strong dollar is giving the foreign competition a huge advantage. Once an industry (such as electronic chips or shoes or cameras) is lost to foreign manufacturers, that industry is gone. You never get it back.

The tide of cheap foreign goods is now helping to keep inflation down in the US. The foreign competition is preventing US manufacturers from raising their prices. But eventually, the loss of markets is going to result in recession here. When that happens, the dollar is going to weaken if only because interest rates will come down. And then the trouble will start as the dollar's strength starts to unwind.



RUSSELL'S MUSINGS: On September 7 the Wall Street Journal published an article that I've been expecting for a long time. The article was entitled, "Seers' Slump, Business Forecasters Find Demand is Weak in Their Own Product." The gist of the article was that due to bad forecasting and widespread amateur computer use, the economists and forecasters have been having a hard time.

Over the past ten years business, stock market and economic forecasting has been one of the hottest areas around. My feeling is that era has passed its peak and the fortunes of the seers are heading down. I've written before about the explosive growth of investment advisors. When I started in this business the number of investment advisors in the nation could be counted in the very low hundreds. They are now counted in the multi-thousands.

There are a number of reasons why many of today's advisories are going to go under. (1) There is normally a big turnover in this business, and the turnover is going on today the same as it was twenty years ago. (2) An advisor develops a big following, he becomes a Wall Street guru. Then he goofs horribly on a big turn in the market, and his audience departs. (3) An advisor forgets that he's in business. His accountant calls up one day and tells him that his expenses are way above his income. He folds his tent. (4) An advisory publication expands rapidly during a bull market. When the inevitable bear market hits, the advisor isn't ready for the contraction. Kaput. (5) The advisor is a bore. He's brilliant, he's often right, but nobody can stand reading him. He fades away. (6) An advisor develops a great forecasting device. He gathers a large following based on the device's success in the market. Suddenly, the device ceases to work. His business is over too.

I've been sensing this one for a long time, and I've been writing about it: Today's high interest rates have been exerting a subtle change in the investment business. The change has been brought about with the help of a phenomenon known as compounding. The rule is simple enough, but it's also financial dynamite. Here it is. You don't need a financial guru to make money for you if you (1) can save, (2) can stick to a plan, (3) can understand the magic of compounding money.

I've written about this maybe a dozen times, but here goes again. Over any ten year period very few professional money managers or advisors can make as much as 12% a year compounded. But today government bonds will yield over 12% and municipal bonds will yield around 10% (with no taxes).

Slowly, very slowly, this concept is seeping into the minds of individuals, pension managers, fund managers, businessmen. As The concept of getting rich by compounding takes over, the need for all the thousands of advisory publications and all the idea and concept people subsides..

THINK ABOUT THIS CAREFULLY! If bonds guarantee a 12% return, the only reason for buying stocks is to get a comparable or better return in LESS TIME. Let me put it this way. If I buy a municipal bond at a 10% yield I will double my money in a bit over 7 years. And there will be no taxes on my profits. To equal that, any stock I buy will have to provide yield and appreciation which will better than double the total return in 7 years. I say better than double its total return because there will be taxes to pay on the ultimate profits.

Thus stocks and money managers and advisors have a tough job ahead of them. There's a new world out there, a world of debts and high interest rates. Ten years ago (and you probably remember this well) the "smart boys" were telling everybody to "go into debt, because you'll pay off with cheap dollars." Now the smart thing to do is to buy the debt. Few advisors will tell you that. Why won't they? Because to tell you to buy the debt means that you have a lot less use for their services.

Question: OK Russell, if all this is true, how is it that you are so magnanimous? Why are you giving us all this brilliant information?

Answer: I've been writing about compounding for years (ever since rates went sky-high). Happily, I have a large number of sophisticated subscribers who tend to stay with me over the years. They want information, concepts, investment thoughts. My subscribers aren't looking for "the stock of the month" or "ten ways to get rich this year." I've got one major secret, and it may be the reason why I've been able to stay in business since the 1950's. The secret is that I write what I'm thinking about, and I put my mouth where my money is (no, I didn't reverse that sentence, I put my mouth where my money is). Over the past few years I've had 85% of my money at high interest rates and compounding. It's still there, and I haven't lost any sleep over it yet.

CONVERSATION with Melvyn Lippman of US Organization Chart Service in La Jolla. Lippman publishes information on the entire military and industrial complex and is an expert on the military.

Lippman: The US is going full speed ahead on the star wars systems. The technology is now in place. It's simply a matter of translating that technology into weaponry.

Russell: What are the implications?

Lippman: First, the future of the US depends on our moving into space technology and weaponry. The Russians are moving or have moved ahead of us in the areas of the army, the navy and the air force. We must under no circumstances allow the Russians to dominate in space.

Russell: You say the Russians are dominant in the air force?

Lippman: Let me explain. Our air force is carrier based. It is therefore highly vulnerable. The Russians are ground based. Russian air power can attack any part of the US now.

Russell: How much is the star wars weaponry going to cost?

Lippman: We can start with $100 billion, but it will cost far more. But the US is going ahead full blast in this area. All the major military laboratories are working on this. Our military and anyone closely connected with the military knows that the space projects amount to a life and death effort for the US. But we are moving into space. And the cost will impact the US economy, and in many ways it will drain it. There are going to be whole new industries and giant new companies based on huge development and production contracts. Furthermore, many old-line established companies will wither away as the whole thrust of the military moves towards space rather than the established, out-dated weaponry of today.

Russell: Mel, how is this all going to be implemented?

Lippman: You probably aren't aware of this, but recently Defense Secretary Weinberger appointed Lt. General James Abrahamson to head a new military command entitled Strategic Defense. The appointment was approved by the US Senate.

Strategic Defense is in actuality,an embryonic space command and in due time this new command could have the status of the present army or navy. Mull that over, and you'll have some idea of the vastness and the importance of the coming rush into space.

NOTES & QUOTES: Few people have recognized it, few people have put it all together yet – but Keynesianism is just about DEAD. First to sink it was conservative Maggie Thatcher of Britain, then conservative Ronald Reagan in the US, and this year President Mitterand of France (in a reversal so abrupt that the Socialists and Communists never knew what hit them). Then last week Canada tossed out the liberals as Brian Mulroney roared to a landslide victory – thereby putting the conservatives in the saddle in Canada for the first time since 1958.

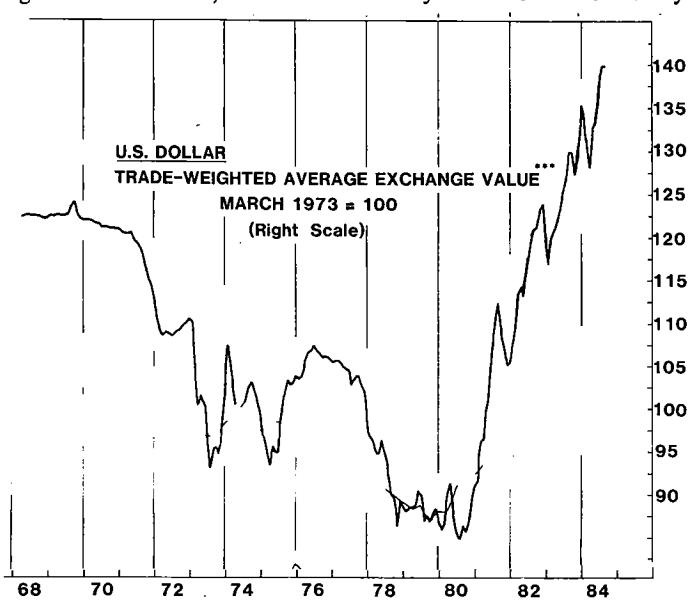
All this tells me two things: (1) The tide of economic liberalism, welfare spending, sky-high deficits and the pension society is coming to an end. Why? Simple; it doesn't work. No society in history has ever survived by requiring one half of the people to support the other half. (2) The new tide tells me that Ronald Reagan is going to sweep the November election. The American people have had it with the Great Society. This year they will be voting for something new – the Solvent Society.

* *

The King: After gold broke wide in 1980-81, I wrote column after column stating that "the dollar would be king." This chart (courtesy of the Bank Credit Analyst) shows the dollar in terms of a trade-weighted exchange value, and you can see the direction has been straight up. The extraordinary thing about the rise is that it has continued in the face of all kind of professional warnings. "The dollar is too high." "This move can't last." "When the dollar goes, it's going to be a total collapse." And so forth. But the strength in the dollar goes on and on.

Why? What's happening? What's happening is that the world is awash in debt, and that debt is in dollars. As the pressure increases to pay the interest on the debts and to pay off the debts themselves, the GREAT NEED is for dollars. The fact is that the massive dollar debts constitute a gigantic short position against the dollar.

On top of that, of course, is the fact that the dollar pays a very high rate of return, and the dollar buys a lot in almost every country in the world. In other words, if you have dollars today, you are king.



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An island: Andy Strasberg, director of marketing for the San Diego Padres, pointed out the problem of getting fans in to see the division-leading baseball team: "We're truly unique to American sport. We're bordered on the west by water (Pacific Ocean), on the south by a foreign country (Mexico), on the north by two of the most populous areas in the world (Orange County and Los Angeles), and on the east by a vast, dry desert (Anza Borrego desert)." All of which makes San Diego the playground of the West, but it's hard on sports teams.

* *

There's nothing like a big strike at GM to cool off the economy. And that's just what could be on the way. And the bond market likes it.

* *

I don't know if it:s good or bad or a commentary on modern times, but in the years before World War II there was usually a "resident wise man" or "resident humorist" in the US. He was invariably an older man, a famous man and a man whose words made the newspapers all over the land. At times he was a Mark Twain, at times he was a Will Rogers or an H.L. Mencken. At any rate,I miss this fellow, and I thought this quote by Mark Twain would bring a smile to older readers:

> **If you pick up a starving dog and make him prosperous, he will not bite you. This is the principal difference between a dog and a man.**
>
> **Mark Twain**

* *

Because I'm a read-a-holic, I read gad-knows-how-many magazines and newspapers in the course of any given day. Daily Variety is one of the papers I read, mainly because I have many friends and a daughter in show business. Just because Variety caters to show business, don't think it is biased in its movie reviews. No, Variety is tough, and some of its reviews are classics. For instance, here's an example, the example being the newly-released "Bolero" starring Bo Derek:

> **There's a real good cartoon at the Hollywood Pacific this week in which a horse does funny things with Woody Woodpecker, followed by "Bolero" in which Bo Derek does funny things with a horse, her hair and a couple of men. Judging from the audience's reaction, the cartoon will be around longer.**

* *

Lord, Give Me Strength Dept.: I never could figure it. A guy buys a car and it's a lemon, so he raises absolute hell with the dealer. But the same guy goes into a restaurant and gets a bum meal, and he never says a thing. He just pays, tells the waiter, "It was fine," and walks out.

Last week I met an old friend at the fashionable Bel Air Hotel in LA. We had lunch by the pool. I asked for a cold salmon salad, and they brought me smoked salmon (after a 45-minute wait). They served little commercial crackers wrapped in paper instead of bread, so I asked for rolls instead. They then brought

two stale rolls for four of us! Finally, I asked for decaffeinated coffee, and they said they only had Sanka. At this point I was ready to toss a bomb into the kitchen, but I was the guest so I couldn't complain too loudly.

I understand Mrs. Hunt (of the Texas Hunts) owns the Bel Air. If any of my Texas subscribers see Mrs. H., please tell her the kitchen at the Bel Air Hotel doesn't know what it 's doing. Please. ...

* *

Mondale has come up with his typically Democratic method of shrinking the deficit. Slap a surtax on the rich. But the figures don't bear him out. Raising the taxes for the rich would discourage the wealthy without really bringing in the tax receipts. Consider this: If everyone in the US who was making $100,000 or more were hit with a massive flat tax of 75%, the additional revenue to the government would be only $16.9 billion (in the face of a deficit of over $160 billion). If everyone in the US with an income of over $500,000 was hit with a 75% flat tax, it would raise only $6.8 billion for the government. Conclusion: If you really want to raise money, you have to have a national sales tax or a national flat tax that hits everyone.

* *

Nobody has come out and said it yet, but Fritz Mondale has all the appearances of a political disaster. The very liberal Washington Post Weekly came out with a cartoon in which a man is looking at a huge sign spelled Mon-DULL. The Post complains that "many voters have no clear idea about Mondale," and, well, here's a clip from the Post article:

> Back in January, a Washington Post-ABC News poll showed one-quarter of the public neither liking nor disliking Mondale but rather looking at him as a question mark, and expressing no opinion about him at all. Seven months later, after constant and tough campaigning, it appears that the Minnesotan may have dulled rather than sharpened his image.

* *

THIN: USA Today (Sept. 6) runs an article headlined, "Resorts to Keep People Thin are In." They then go on to say that "folks pay up to $2,000 for a week at the 'fat farm'." Well, I can save you that $2,000. All you have to do is eat right and walk a few miles a day.

Here's what you eat, and this is how I live (by the way, this is straight from the famous Pritikin diet). You eat a breakfast of orange juice, shredded wheat and non-fat (not low-fat, non-fat) milk and decaffeinated coffee (slice a fresh peach on the shredded wheat if you want, but NO SUGAR).

For lunch, make a salad of lettuce, cucumbers, tomatoes, cauliflower and a NON-fat yogurt for dressing or a vinegar and lemon juice dressing. Still hungry? Eat a few whole wheat pita bread slabs (also known as Lebanese bread – made of whole wheat and water).

Dinner: Try to stay with vegetables, pasta, chicken or fish. Try to use little or no oils, fats, salt, sugar. Eat little or no meat or cheese (most meat is at least 15% fat, most cheese runs up to 40 % fat). Stay away from ice cream (which is sugar, salt, fat or oil) and almost all baked goods and fancy deserts. Eat fruit for desert.

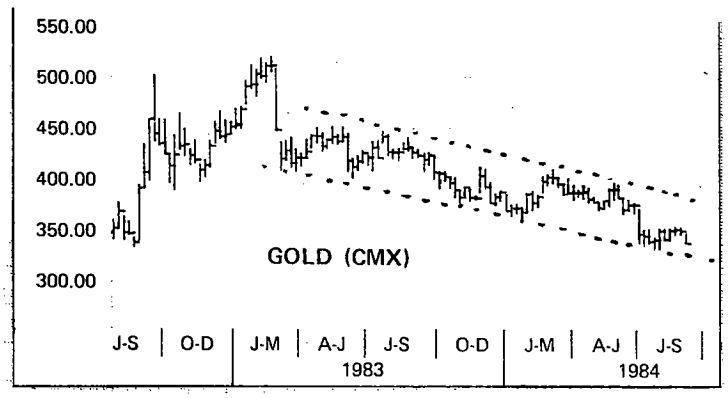
A critical point: It's much easier to CHANGE your diet than it is to cut down on your food intake. Few people can cut down, but anyone with a will can change from a high-fat, junk diet to a good, low-fat, no-salt, no-sugar diet.

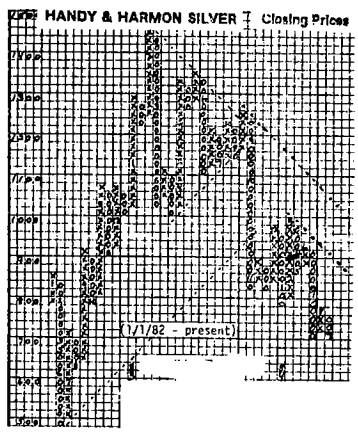
Observation: Once you really get off fats and oils, you'll become almost nauseous when you eat an oily or fatty dinner. Just as ex-smokers hate cigarettes, ex-junkers hate fats and oils.

GOLD: My ratio of gold to common stocks (NYSE Composite) just dropped to a four-year low. I keep a three-week and an eight-week moving average of this important ratio, and they too have dropped to four-year lows. I have noticed that when this ratio (which is really a relative strength gauge) is declining in favor of stocks over gold, such action constitutes a negative background for the metal. In other words, gold seldom acts well when this telltale ratio is declining. In fact, the steadily dropping gold/common stock ratio is one of the items that has kept me cool on the yellow metal all during 1984.

I don't like to be a wise guy, but gold has never been easier to read than during 1983 and 1984. It's simply been walking down this channel, as seen on the weekly chart. I published this chart (courtesy of Dunn & Hargitt) many times over the last year or so, and I've always said the same thing, "Gold is in a major bear trend. Leave it alone."

The point & figure chart of silver is as bad as the gold chart. The place to be now is in the stock or bond market, not the precious metals markets. But I think I've said that before.





LATE NOTES: The week ending Sept. 14 saw new recovery highs for the S&P 500, the NYSE Composite and an important upside breakout by the Value Line Composite at 184.70 (see last Letter). Confirmation by the D-J Averages would entail a bettering of 1236.53 by Industrials and 528.57 by Transports.
Sept. 14 saw new 1984 highs by the NYSE Industrials, the S&P 400 Industrials and the S&P Utility Average. Hardly a bear market performance.

NEXT MAILING: October 3